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Bachelor of Commerce (B2001) | Level 2 • Part B Major | Monash University

Financial accounting

Course Code: ACC2100 • Module 3 Notes

Module 3: Leases, Provisions, Financial Instruments & Revenue Recognition

1. Lease Accounting (AASB 16)

1.1 Identifying a Lease vs a Service Contract

AASB 16 Leases replaced the legacy distinction between operating and finance leases for lessees with a single on-balance-sheet right-of-use model, eliminating off-balance-sheet operating lease arbitrage. At contract inception, an entity must assess whether the contract is, or contains, a lease. A contract contains a lease if it conveys the **right to control the use of an identified asset** for a period of time in exchange for consideration. Control requires three cumulative conditions:

1. **Identified Asset:** The asset is explicitly specified in the contract (or implicitly specified when made available) and the supplier does not have a *substantive substitution right* (i.e., the supplier cannot practically substitute alternative assets throughout the period of use and benefit economically from doing so).
2. **Right to Obtain Substantially All Economic Benefits:** The customer holds exclusive rights to virtually all economic outputs, sub-leasing benefits, or by-products from using the asset during the period of use.
3. **Right to Direct the Use:** The customer has the right to direct how and for what purpose the asset is used throughout the period of use (rather than operating under pre-determined supplier instructions where the customer merely receives a service output).

Lessees may elect two optional recognition exemptions under *AASB 16* paragraph 5: (a) **short-term leases** (lease term of 12 months or less with no purchase option, elected by class of underlying asset), and (b) **leases of low-value assets** (such as tablets, personal laptops, or small office furniture, assessed on an absolute new-value basis of roughly US$5,000 / A$7,500 or less, elected lease-by-lease). Under these exemptions, lease payments are expensed straight-line over the lease term.

1.2 Lessee Initial and Subsequent Measurement

At the commencement date (the date the lessor makes the underlying asset available for use), a lessee recognises a **Lease Liability** and a **Right-of-Use (ROU) Asset**. The Lease Liability is measured initially at the present value of future lease payments not paid at the commencement date, comprising: fixed payments (less any lease incentives receivable), variable lease payments linked to an index or rate (such as Australian CPI), amounts expected to be payable under residual value guarantees, the exercise price of a purchase option if the lessee is reasonably certain to exercise it, and termination penalties if the lease term reflects exercising a termination option. Payments are discounted using the **interest rate implicit in the lease** if readily determinable, or otherwise the lessee's **incremental borrowing rate (IBR)**:

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$$LL_0 = \sum_{t=1}^{n} \frac{PMT_t}{(1+r)^t} + \frac{RVG_n \text{ or } PO_n}{(1+r)^n}$$

Where: LL_0 is the initial Lease Liability at commencement date, PMT_t is the periodic lease payment at period t, RVG_n or PO_n is any expected residual value guarantee payment or reasonably certain purchase option price at the end of term n, and r is the discount rate (rate implicit in the lease or incremental borrowing rate).

The initial cost of the **Right-of-Use Asset** is calculated from the initial Lease Liability plus upfront cash flows and restoration obligations:

$$ROU_0 = LL_0 + \text{Prepayments} - \text{Lease Incentives Received} + \text{Initial Direct Costs} + PV\,(\text{Restoration})$$

Where: ROU_0 is the initial cost of the Right-of-Use Asset, LL_0 is the initial Lease Liability, Prepayments are lease payments made at or before commencement, Lease Incentives Received are cash incentives reimbursed by the lessor, Initial Direct Costs are incremental costs of obtaining the lease (e.g., legal commissions), and $PV\,(\text{Restoration})$ is the present value of dismantling/make-good obligations recognised as a provision under *AASB 137*.

Subsequently, the Lease Liability is accounted for using the **effective interest method**: interest accrues each period on the opening liability balance (Interest_t = LL_{t-1} × r) and reduces as lease payments are made ($LL_t = LL_{t-1} + Interest_t - PMT_t$). The ROU Asset is generally depreciated straight-line under *AASB 116* over the **shorter** of the lease term and the asset's useful life—unless ownership transfers to the lessee by the end of the lease term or the lessee is reasonably certain to exercise a purchase option, in which case depreciation runs over the asset's full useful life. Note also that under *AASB 112* (as amended for single-transaction deferred tax), recognising an equal ROU asset and lease liability at commencement creates simultaneous equal taxable and deductible temporary differences, requiring gross recognition of a DTL on the ROU asset and a DTA on the lease liability.

1.3 Lessor Classification Overview

Unlike lessees, lessors under *AASB 16* retain the dual classification model. A lease is classified as a **finance lease** if it transfers substantially all the risks and rewards incidental to ownership of an underlying asset (indicators include ownership transfer, bargain purchase option, lease term covering the major part of economic life, or present value of lease payments amounting to substantially all of fair value); otherwise it is an **operating lease**. In a finance lease, the lessor derecognises the asset and recognises a Lease Receivable equal to the net investment in the lease; in an operating lease, the lessor retains the asset on its balance sheet and recognises lease income straight-line.

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1.4 Worked Lessee Amortisation Schedule and Journal Entries (AUD)

Port Phillip Logistics Ltd enters into a 4-year non-cancellable lease for a heavy reach-stacker forklift starting 1 July 2026 (financial year end 30 June). Terms: annual lease payments of A$80,000 payable in arrears on 30 June each year (2027–2030); the lease includes a bargain purchase option at 30 June 2030 of A$20,000 that Port Phillip is reasonably certain to exercise; the underlying forklift has an economic useful life of 6 years with zero residual value at Year 6; Port Phillip pays A$8,000 in initial direct legal/brokerage fees on 1 July 2026 and receives a A$3,000 cash incentive from the lessor on commencement. The interest rate implicit in the lease is 7% per annum.

Step 1: Compute Initial Lease Liability and ROU Asset at 1 July 2026

Using present value factors at r = 7%: PV annuity factor for 4 years = $(1 - 1.07^{-4}) / 0.07 = 3.387211$; PV lump-sum factor for Year 4 = $1.07^{-4} = 0.762895$:

$$LL_0 = (80{,}000 \times 3.387211) + (20{,}000 \times 0.762895)$$
$$= 270{,}977 + 15{,}258 = \text{AUD } 286{,}235$$

Where: 80,000 is the annual lease payment in arrears, 20,000 is the reasonably certain purchase option price at Year 4, and $0.07 is the 7% implicit rate. Adding initial direct costs (A8,000) and subtracting the lease incentive received (A$3,000) gives initial ROU Asset cost:

$$ROU_0 = 286{,}235 + 8{,}000 - 3{,}000 = \text{AUD } 291{,}235$$

Where: ROU_0 is the initial carrying amount of the Right-of-Use Asset at 1 July 2026. Because the lessee is reasonably certain to exercise the purchase option, the ROU Asset is depreciated over the asset's full **6-year economic useful life** (not the 4-year lease term): Annual Depreciation = 291,235 / 6 = A$48,539.

Step 2: Complete 4-Year Lease Liability Amortisation Schedule (AUD)

Year Ended	Opening Liability (AUD)	Interest Expense at 7% (AUD)	Cash Payment (AUD)	Principal Reduction (AUD)	Closing Liability (AUD)
30 Jun 2027	286,235	20,036	80,000	59,964	226,271
30 Jun 2028	226,271	15,839	80,000	64,161	162,110

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Year Ended	Opening Liability (AUD)	Interest Expense at 7% (AUD)	Cash Payment (AUD)	Principal Reduction (AUD)	Closing Liability (AUD)
30 Jun 2029	162,110	11,348	80,000	68,652	93,458
30 Jun 2030	93,458	6,542*	100,000	93,458	0

**Note: Final year interest of A$6,542 reflects A$1 rounding adjustment (93,458 × 7% = 6,542.06), and final payment of A$100,000 equals A$80,000 annual rent plus A$20,000 purchase option exercise.*

Step 3: Year 1 Journal Entries and Statement of Financial Position Split (FY2027)

Date	Account Description	Debit (AUD)	Credit (AUD)
1 Jul 2026	Right-of-Use Asset – Forklift	286,235	
	Lease Liability		286,235
1 Jul 2026	Right-of-Use Asset – Forklift (net of A$3,000 incentive)	5,000	
	Cash at Bank (A$8,000 direct cost paid – A$3,000 received)		5,000
30 Jun 2027	Interest Expense (Finance Costs – P&L)	20,036	
	Lease Liability (Principal reduction)	59,964	
	Cash at Bank		80,000
30 Jun 2027	Depreciation Expense – ROU Asset	48,539	
	Accumulated Depreciation – ROU Asset		48,539

At 30 June 2027, the ROU Asset carrying amount is 291,235 − 48,539 = A$242,696. The total closing Lease Liability of A$226,271 is split on the Statement of Financial Position into a **Current Lease Liability** of A$64,161 (the principal due within 12 months in FY2028) and a **Non-Current Lease Liability** of A$162,110.

Lease Liability (Initial & Subsequent)

Initial: PV of unpaid lease payments at implicit rate / IBR

Subsequent: + Effective interest (P&L) – Cash lease payments

Right-of-Use (ROU) Asset

Initial: Lease Liability + Direct Costs + Prepay – Incentives

Subsequent: – Depreciation (shorter of term/life, or full life if PO)

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AASB 112 Single-Transaction Deferred Tax Rule

Recognise gross DTL on ROU Asset (CA > TB=0) and gross DTA on Lease Liability (CA > TB=0) from Day 1

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1.5 Lease Modifications, Variable CPI Adjustments & Tax-Effect Mechanics

Commercial property and equipment leases in Australia frequently include annual Consumer Price Index (CPI) rent escalations or subsequent mid-term extensions. Under *AASB 16*, when variable lease payments depend on an index or rate (such as Australian CPI), the Lease Liability is **remeasured** only when a change in the cash flows actually takes effect (using an unchanged discount rate), with a corresponding adjustment to the ROU Asset. By contrast, a **lease modification**—a change in the scope or consideration of a lease that was not part of the original terms—is accounted for as a separate lease only if it adds the right to use one or more additional underlying assets at a stand-alone price; otherwise, the existing Lease Liability is remeasured using a **revised discount rate** at the modification effective date, and the ROU Asset is adjusted accordingly (or reduced proportionally with a gain/loss in P&L if scope decreases).

Because the ATO allows tax deductions strictly for actual cash lease rentals paid (rather than accounting depreciation and effective interest), the tax base of both the ROU Asset and the Lease Liability is generally A$0. Applying the *AASB 112* single-transaction amendment to Port Phillip Logistics Ltd at 30 June 2027: the ROU Asset carrying amount of A$242,696 creates a TTD and DTL of 242,696 × 30% = A$72,809, while the Lease Liability carrying amount of A$226,271 creates a DTD and DTA of 226,271 × 30% = A$67,881, resulting in a net closing Deferred Tax Liability of A$4,928.

2. Provisions, Contingent Liabilities and Contingent Assets (AASB 137)

2.1 Provisions vs Accruals vs Contingent Liabilities

AASB 137 Provisions, Contingent Liabilities and Contingent Assets regulates liabilities characterised by uncertainty in timing or amount. Unlike trade payables (certain invoices) or accruals (goods/services received with minor estimation uncertainty), a **provision** is defined as a liability of uncertain timing or amount. Under *AASB 137* paragraph 14, a provision is recognised in the Statement of Financial Position when and only when three cumulative criteria are met:

1. **Present Obligation from a Past Event (Obligating Event):** The entity has a *legal obligation* (arising from a contract, legislation, or operation of law) or a *constructive obligation* (created when an established pattern of past practice, published policies, or a sufficiently specific current statement creates a valid expectation in other parties that the entity will discharge certain responsibilities).
2. **Probable Outflow of Resources:** It is more likely than not (probability > 50%) that an outflow of resources embodying economic benefits will be required to settle the obligation.
3. **Reliable Estimate:** A reliable estimate can be made of the amount of the obligation (almost always achievable using statistical ranges).

If any of these three criteria fails, no liability is recognised on the balance sheet; instead, the item is evaluated as a **contingent liability** (a possible obligation confirmed only by uncertain future events not wholly within the entity's control, or a present obligation failing the probability or measurement threshold). Contingent liabilities are **disclosed in the notes** unless the probability of outflow is *remote*. Conversely, **contingent assets** (possible assets arising from past events, such as pending litigation damages) are never recognised on the balance sheet; they are disclosed in the notes only if an inflow is *probable* (> 50%), and recognised as an actual asset only when realisation of income is **virtually certain**.

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2.2 Measurement, Discounting, Onerous Contracts & Restructuring

The amount recognised as a provision is the **best estimate** of the expenditure required to settle the present obligation at the reporting date. Where the provision involves a large population of items (such as product warranties), the obligation is estimated using the **expected value** method (weighting all possible outcomes by their associated probabilities). Where a single obligation is being measured (such as an environmental clean-up or legal settlement), the individual **most likely outcome** may be the best estimate, adjusted upward or downward if other possible outcomes are mostly higher or lower.

Where the effect of the time value of money is material, the provision must be discounted to its present value using a **pre-tax discount rate** reflecting current market assessments of the time value of money and the risks specific to the liability (to avoid double counting, risks already reflected in cash flow estimates are excluded from the discount rate). Each period, the increase in the provision reflecting the passage of time—known as the **unwinding of the discount**—is recognised in profit or loss as a borrowing/finance cost.

Two recurring corporate applications under *AASB 137* require special vigilance:

- **Onerous Contracts:** A contract in which the unavoidable costs of meeting the obligations under the contract exceed the economic benefits expected to be received under it. Under *AASB 137* (including the 2020 amendments on cost of fulfilling a contract), the entity recognises the present obligation under an onerous contract immediately as a provision, measured at the lower of the cost of fulfilling the contract (comprising both incremental direct costs and an allocation of directly related overhead costs) and any compensation or penalties arising from failure to fulfil it.
- **Restructuring Provisions:** Provisions for future operating losses are strictly prohibited. A restructuring provision (e.g., closing a factory or terminating a business division) may be recognised *only* when the entity has a detailed formal plan (identifying the business, locations, employee numbers, expenditures, and timeline) AND has raised a valid expectation in those affected by starting to implement the plan or announcing its main features. Only direct, necessary restructuring expenditures—never ongoing staff retraining, marketing, or relocation of continuing operations—may be included.

2.3 Worked Numerical Examples: Environmental Restoration & Warranties (AUD)

Part A — Discounted Site Rehabilitation Provision: Pilbara Minerals Processing Ltd constructs an ore-processing facility on 1 July 2026 costing A$4,500,000 in cash with a 5-year operating life. Western Australian environmental legislation obliges the company to dismantle the plant and rehabilitate the land on 30 June 2031 at an estimated future cash cost (incorporating inflation and risk adjustments) of A$600,000. The appropriate pre-tax risk-free discount rate is 6% per annum.

At 1 July 2026, the present value of the restoration obligation is:

$$PV_0 = \frac{600{,}000}{(1.06)^5} = 600{,}000 \times 0.747258 = \text{AUD } 448{,}355$$

Where: 600,000 is the estimated future cash outflow at Year 5, and $0.06 *is the 6% pre-tax discount rate. Under* AASB 116, *this* A$448,355 is capitalised into the cost of the Facility (bringing total Facility cost to A$4,500,000 + A$448,355 = A$4,948,355, depreciated at A$989,671/year over 5 years) and credited to Provision for Site Rehabilitation.

At 30 June 2027 (end of Year 1), the unwinding of the discount is 448,355 × 6% = A$26,901 (Dr Finance Cost – Unwinding of Discount A$26,901 / Cr Provision for Site Rehabilitation A$26,901), raising the closing provision to A$475,256. At 30 June 2028 (Year 2), unwinding is 475,256 × 6% = A$28,515, raising the provision to A$503,771, continuing until it reaches exactly A$600,000 on 30 June 2031.

Part B — Expected Value Warranty Provision: During FY2027, an Australian appliance manufacturer sells 10,000 washing machines with a statutory and manufacturer 12-month defect warranty. Historical engineering data indicate that 82% of units will have no defects (A$0 repair cost), 13% will have minor valve faults (A$120 repair cost per unit), and 5% will have major motor faults (A$480 repair cost per unit). Actual cash warranty repairs incurred on FY2027 sales prior to 30 June 2027 totalled A$145,000.

$$\begin{aligned}\text{Total Expected Warranty Cost} &= 10{,}000 \times [(0.82 \times 0) + (0.13 \times 120) + (0.05 \times 480)] \\ &= 10{,}000 \times (15.60 + 24.00) = \text{AUD } 396{,}000\end{aligned}$$

Where: 10,000 is units sold, and 15.60 + 24.00 = A$39.60 is the probability-weighted expected warranty cost per unit. Because A$145,000 of claims were already settled in cash during FY2027, the closing Provision for Warranties at 30 June 2027 is 396,000 − 145,000 = A$251,000.

3. Financial Instruments (AASB 9 & AASB 132)

3.1 Liability vs Equity Classification and Compound Instruments (AASB 132)

AASB 132 Financial Instruments: Presentation distinguishes financial liabilities from equity instruments based on **substance over legal form**. A financial liability exists whenever an issuer has a *contractual obligation* to deliver cash or another financial asset to another entity (or to exchange financial instruments under potentially unfavourable conditions). For example, mandatorily redeemable preference shares carrying a fixed non-discretionary dividend are classified as **financial liabilities**, and their dividends are recognised as interest expense in profit or loss—even though legally termed "shares".

A **compound financial instrument** (such as a convertible note) contains both a liability component (obligating fixed coupon payments and potential cash redemption) and an equity component (the holder's option to convert into a fixed number of ordinary shares). Under *AASB 132* paragraph 28, the issuer splits the proceeds at inception using the **residual method**: (1) measure the fair value of the liability component first by discounting contractual coupon and principal cash flows at the market interest rate for an equivalent *non-convertible* bond; (2) assign the residual difference (Issue Proceeds minus Liability Fair Value) to Equity (Convertible Note Equity Reserve).

3.2 Classification & Measurement of Financial Assets and Liabilities (AASB 9)

AASB 9 Financial Instruments classifies financial assets into three measurement categories based on two analytical tests: (1) the entity's **Business Model** for managing the asset, and (2) the contractual cash flow characteristics test—whether cash flows represent **Solely Payments of Principal and Interest (SPPI)** on the principal amount outstanding.

Measurement Category	Eligibility Criteria Under AASB 9	Balance Sheet & Profit or Loss Impact
Amortised Cost (AC)	Business model is *Hold to Collect* contractual cash flows AND contractual cash flows pass the *SPPI* test (e.g., trade receivables, corporate term loans, fixed-rate government bonds held to maturity).	Measured using the effective interest method; interest revenue and ECL impairment losses/reversals recognised in Profit or Loss. Transaction costs added to initial carrying amount.
Fair Value Through OCI (FVOCI – Debt)	Business model is *Hold to Collect AND Sell* AND contractual cash flows pass the *SPPI* test (e.g., liquidity portfolios held by Australian banks).	Carried at fair value; unrealised fair value gains/losses recognised in OCI (recycled to P&L on derecognition). Effective interest and ECL impairment recognised in P&L.
Fair Value Through OCI (FVOCI – Equity Election)	Irrevocable election at initial recognition for non-trading strategic *equity investments* (shares do not pass SPPI).	Carried at fair value; fair value changes recognised in OCI and **never recycled** to P&L upon sale (dividends go to P&L).
Fair Value Through Profit or Loss (FVTPL)	Default / residual category: held for trading, derivatives, managed on a fair value basis, or failing the SPPI test (e.g., equity investments not elected FVOCI, convertible bond assets).	Carried at fair value; all fair value changes and transaction costs recognised immediately in Profit or Loss.

Financial liabilities are generally measured at **Amortised Cost** using the effective interest method (except derivatives and trading liabilities measured at FVTPL). Transaction costs directly attributable to issuing a financial liability at amortised cost (such as bond underwriting fees) are *deducted* from the initial liability proceeds, raising the effective interest rate above the coupon rate.

3.3 Expected Credit Loss (ECL) Impairment Model

Replacing the delayed "incurred loss" model, *AASB 9* implements a forward-looking **Expected Credit Loss (ECL)** model requiring entities to recognise credit loss allowances before an actual default occurs:

- **General Three-Stage Model (for loans and debt securities):** At origination, assets sit in **Stage 1** and carry a 12-month ECL allowance (interest calculated on gross carrying amount). If credit risk increases significantly since initial recognition, the asset moves to **Stage 2** and carries a lifetime ECL allowance (interest still on gross carrying amount). If an asset becomes credit-impaired (defaulted), it moves to **Stage 3** with lifetime ECL and interest calculated on the net carrying amount.
- **Simplified Approach (mandatory or elected for Trade Receivables & Contract Assets):** Entities bypass 12-month tracking and recognise **lifetime ECL** from day one, typically operationalised via an ageing **provision matrix** calibrated with historical default rates and

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forward-looking Australian macroeconomic indicators (such as RBA cash rate shifts and unemployment forecasts).

3.4 Worked Financial Instrument Examples in AUD

Example 1 — Amortised Cost Corporate Bond Issue: On 1 July 2026, Southern Grid Energy Ltd issues 5-year corporate bonds with a face value of A$1,000,000 and an annual coupon of 5% (A$50,000 paid every 30 June) at a market yield of 6%, raising gross proceeds of A$957,876 (50,000 × 4.212364 + 1,000,000 × 0.747258). The company also pays A$16,876 in direct bond issuance legal and underwriting fees, yielding net initial proceeds of 957,876 − 16,876 = A$941,000. Using financial solver iteration, the effective interest rate that equates net proceeds of A$941,000 to the future cash outflows (A$50,000 for 5 years plus A$1,000,000 at Year 5) is $r_e = 6.423\%$ per annum.

Year Ended	Opening Bond Liability (AUD)	Effective Interest at 6.423% (AUD)	Cash Coupon at 5% (AUD)	Discount/Fee Amortisation (AUD)	Closing Bond Liability (AUD)
30 Jun 2027	941,000	60,440	50,000	10,440	951,440
30 Jun 2028	951,440	61,111	50,000	11,111	962,551
30 Jun 2029	962,551	61,825	50,000	11,825	974,376

On 1 July 2026: Dr Cash at Bank A$941,000 / Cr Bond Liability A$941,000. On 30 June 2027: Dr Interest Expense A$60,440 / Cr Cash at Bank A$50,000 / Cr Bond Liability A$10,440.

Example 2 — Simplified ECL Provision Matrix: At 30 June 2027, an ASX-listed wholesaler holds A$1,200,000 of gross trade receivables (opening Allowance for ECL on 1 July 2026 was A$28,000; during FY2027 A$19,000 of uncollectible accounts were written off against the allowance). Based on historical default rates adjusted for current Australian retail insolvencies, the provision matrix yields: Current (A$800,000 × 1.0% = A$8,000); 1–30 days past due (A$250,000 × 3.0% = A$7,500); 31–60 days past due (A$100,000 × 10.0% = A$10,000); Over 60 days past due (A$50,000 × 35.0% = A$17,500). Total required closing Allowance for ECL = 8,000 + 7,500 + 10,000 + 17,500 = A$43,000. Because the pre-adjustment allowance balance after write-offs is 28,000 − 19,000 = A$9,000, the FY2027 Impairment Loss on Trade Receivables is 43,000 − 9,000 = A$34,000 (Dr Impairment Loss – Trade Receivables A$34,000 / Cr Allowance for ECL A$34,000).

Example 3 — Compound Financial Instrument (Convertible Note Split Under AASB 132): On 1 July 2026, Geelong BioTech Ltd issues 2,000 convertible notes at par value of A$1,000 each (total proceeds A$2,000,000) maturing on 30 June 2029 (3 years). Each note pays an annual cash coupon of 4% (A$80,000 total per year in arrears on 30 June) and is convertible at the holder's option into 200 ordinary shares at maturity, or redeemable in cash at par. An equivalent 3-year non-convertible corporate bond issued by Geelong BioTech carries a market interest rate of 8% per annum. Under *AASB 132*, the liability component is measured first by discounting contractual cash flows at 8% (PV annuity 3 yrs at 8% = 2.577097; PV lump sum Year 3 at 8% = 0.793832):

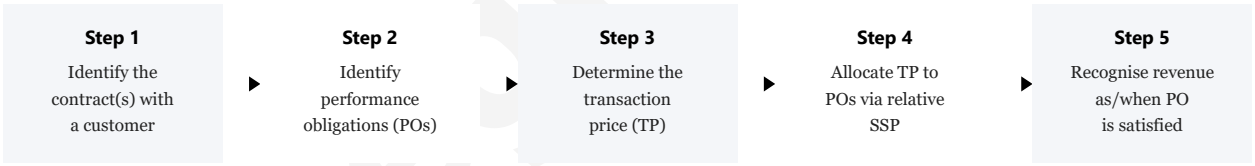
$$\text{Liability Fair Value}_0 = (80{,}000 \times 2.577097) + (2{,}000{,}000 \times 0.793832)$$
$$= 206{,}168 + 1{,}587{,}664 = \text{AUD } 1{,}793{,}832$$

Where: 80,000 is the annual contractual coupon, 2,000,000 is the par redemption principal at Year 3, and 0.08 is the market yield for non-convertible debt. The equity conversion option equals the residual difference: Equity Component = 2,000,000 − 1,793,832 = A$206,168. On 1 July 2026: Dr Cash at Bank A$2,000,000 / Cr Convertible Note Liability A$1,793,832 / Cr Convertible Note Equity Reserve A$206,168. On 30 June 2027, effective interest expense at 8% is 1,793,832 × 8% = A$143,507, cash coupon paid is A$80,000, and the liability carrying amount accretes by 143,507 − 80,000 = A$63,507 to A$1,857,339 (Dr Interest Expense A$143,507 / Cr Cash A$80,000 / Cr Convertible Note Liability A$63,507). The equity reserve of A$206,168 is never remeasured.

4. Revenue from Contracts with Customers (AASB 15)

4.1 The Core Principle and Five-Step Revenue Model

AASB 15 Revenue from Contracts with Customers establishes a comprehensive, principles-based framework for recognising revenue from contracts with customers across all industries. Its core principle is that an entity recognises revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services.



Each step enforces rigorous technical criteria:

- **Step 1 (Identify Contract):** Five criteria must hold: commercial substance, approval and commitment by both parties, identifiable rights regarding goods/services, identifiable payment terms, and probable collection of consideration.
- **Step 2 (Identify Performance Obligations):** A promised good or service is a separate performance obligation if it is **distinct**—meaning (a) the customer can benefit from it on its own or with readily available resources, AND (b) the promise to transfer it is separately identifiable from other promises in the contract (not merely an input to a combined output).
- **Step 3 (Determine Transaction Price):** Consideration excluding amounts collected on behalf of third parties (such as 10% Australian GST). Where consideration includes **variable consideration** (rebates, performance bonuses, volume discounts, rights of return), it is estimated via expected value or most likely amount, but included in the transaction price *only to the extent that it is highly*

probable that a significant reversal in cumulative revenue will not occur once uncertainty resolves (the variable consideration constraint).

- **Step 4 (Allocate Transaction Price):** Allocated to each distinct performance obligation in proportion to its relative **Stand-Alone Selling Price (SSP)**:

$$\text{Allocated Price}_i = \text{Transaction Price} \times \frac{\text{SSP}_i}{\sum_{j=1}^{k} \text{SSP}_j}$$

Where: Allocated Price_i is the transaction price assigned to performance obligation i, SSP_i is the stand-alone selling price of obligation i, and $\sum_{j=1}^{k} \text{SSP}_j$ is the sum of stand-alone selling prices of all k distinct obligations in the bundle. A bundle discount is allocated proportionately across all obligations unless observable evidence proves the discount relates strictly to specific obligations.

- **Step 5 (Recognise Revenue Upon Control Transfer):** Revenue is recognised **over time** if ANY one of three criteria holds: (1) the customer simultaneously receives and consumes the benefits as the entity performs (e.g., cleaning or SaaS hosting); (2) the entity's performance creates or enhances an asset that the customer controls as it is created (e.g., building on customer-owned land); or (3) the asset has no alternative use to the entity AND the entity has an enforceable right to payment for performance completed to date. Otherwise, revenue is recognised at a **point in time** when control passes (evidenced by legal title, physical possession, risks and rewards, and customer acceptance).

Where an entity transfers control of goods or services before the customer pays (and before an unconditional right to consideration arises, other than passage of time), it recognises a **Contract Asset** (distinct from an unconditional Trade Receivable). Conversely, when a customer pays consideration before control transfers, the entity recognises a **Contract Liability** (unearned revenue).

4.2 Worked AASB 15 Examples: Bundled Contract & Over-Time Construction (AUD)

Example A — Bundled Enterprise Software & Support Contract: On 1 July 2026, Melbourne Cloud Solutions Pty Ltd signs a 2-year contract with an enterprise customer for A$180,000 (excluding GST), payable in two instalments: A$100,000 upfront on 1 July 2026 and A$80,000 on 1 July 2027. The bundle delivers: (1) an on-premise enterprise software licence delivered immediately on 1 July 2026 with full standalone functionality (SSP = A$120,000), (2) one-time custom data migration completed on 31 August 2026 (SSP = A$30,000), and (3) 24 months of ongoing cloud technical support from 1 July 2026 to 30 June 2028 (SSP = A$50,000). Total SSP = 120,000 + 30,000 + 50,000 = A$200,000, reflecting a A$20,000 (10%) bundle discount.

Performance Obligation	SSP (AUD)	Weight (%)	Allocated Price (AUD)	Timing & Pattern of Recognition
1. Enterprise Software Licence	120,000	60%	108,000	Point in time: 1 July 2026 (control transfers immediately)

Performance Obligation	SSP (AUD)	Weight (%)	Allocated Price (AUD)	Timing & Pattern of Recognition
2. Custom Data Migration	30,000	15%	27,000	Point in time / completed 31 August 2026
3. 24-Month Technical Support	50,000	25%	45,000	Over time: straight-line A$22,500 in FY2027 & A$22,500 in FY2028
Total Bundle	**200,000**	**100%**	**180,000**	**FY2027 Total Revenue = 108,000 + 27,000 + 22,500 = A$157,500**

Notice the balance sheet mechanics on 1 July 2026 and at 30 June 2027: on 1 July 2026, cash received is A$100,000 while software licence revenue earned immediately is A$108,000. Because the remaining A$8,000 is conditioned on completing data migration/support (or payable on 1 July 2027), the entity recognises a **Contract Asset** of A$8,000 on 1 July 2026 (Dr Cash A$100,000; Dr Contract Asset A$8,000 / Cr Revenue – Licence A$108,000). Once migration finishes on 31 August 2026 (Cr Revenue A$27,000) and 12 months of support elapse by 30 June 2027 (Cr Revenue A$22,500), total FY2027 cumulative revenue is A$157,500 while cash collected is A$100,000, leaving a closing Contract Asset at 30 June 2027 of 157,500 – 100,000 = A$57,500 (which converts to a Trade Receivable when the second A$80,000 instalment is unconditionally invoiced on 1 July 2027).

Example B — Over-Time Construction Contract with Variable Bonus: CivilBridge Australia Ltd contracts on 1 July 2026 to build a regional highway bridge on state-owned land for a fixed price of A$4,000,000 plus a A$300,000 early-completion bonus if finished by May 2028. At 30 June 2027, CivilBridge estimates total expected construction costs at A$3,200,000 and has incurred A$1,280,000 of costs to date. Due to unexpected flood delays in Victoria, management assesses that meeting the early-completion bonus deadline is uncertain (only 40% probability), so under Step 3's variable consideration constraint, the bonus is **excluded** from the transaction price (Transaction Price = A$4,000,000). Because the bridge is built on customer-controlled land, Step 5 satisfies over-time recognition. Using the cost-to-cost input method:

$$\text{Percentage Complete}_{30\ \text{Jun}\ 2027} = \frac{\text{Costs Incurred to Date}}{\text{Total Estimated Costs}} = \frac{1{,}280{,}000}{3{,}200{,}000} = 40\%$$

Where: 1,280,000 is cumulative qualifying contract costs incurred to 30 June 2027, and 3,200,000 is total estimated contract cost. Cumulative revenue recognised in FY2027 is 4,000,000 × 40% = A$1,600,000, construction cost expense is A$1,280,000, and FY2027 gross profit is A$320,000. If the customer has been progress-billed A$1,450,000 to date, the remaining A$150,000 of unbilled earned revenue is presented as a Contract Asset.

Example C — Sale with Right of Return (Refund Liability & Asset Recognition): On 15 June 2027, Melbourne Electronics Wholesale Pty Ltd sells 1,000 smart thermostats to retail stores for A$250 each (total cash received A$250,000; unit inventory cost A$150 each, total cost A$150,000). Under Australian commercial terms, retailers may return unsold units within 60 days for a full cash refund. Based on historical experience across similar product launches, Melbourne Electronics estimates that 6% of units (60 units) will be returned (a constrained expected return rate) and incurs negligible restocking costs. Under *AASB 15* paragraphs B20–B27, revenue is recognised only for the 940 units expected *not* to be returned (940 × 250 = A$235,000), while the remaining 60 × 250 = A$15,000 is recognised as a **Refund Liability**. Simultaneously, Cost of Goods Sold is recognised for the 940 units (940 × 150 = A$141,000), and the expected recoverable inventory (60 × 150 = A$9,000) is recognised as a **Right-to-Recover-Goods Asset** (not left in standard Inventory):

- Dr Cash at Bank A$250,000 / Cr Sales Revenue A$235,000 / Cr Refund Liability A$15,000.
- Dr Cost of Goods Sold A$141,000; Dr Right-to-Recover-Goods Asset A$9,000 / Cr Inventory A$150,000.

4.3 Principal vs Agent Considerations and Contract Costs

In multi-party Australian digital platforms and supply chains, determining whether an entity is a **principal** (recognising gross revenue) or an **agent** (recognising only net commission/fee revenue) depends on whether the entity *controls* the specified good or service before it is transferred to the customer. Indicators of principal status include bearing primary responsibility for fulfilling the promise, holding inventory risk before or after customer order, and having discretion in establishing prices. In addition, incremental costs of obtaining a contract (such as sales commissions that would not have been incurred if the contract had not been won) must be capitalised as a Contract Cost Asset under *AASB 15* paragraph 91 and amortised systematically over the contract period if expected to be recovered (unless the practical expedient for amortisation periods of 12 months or less applies).

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